

MEMO# 35484

October 10, 2023

ICI Files Comment Letter with SEC on Predictive Data Analytics Proposal

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TO: ICI Members
Investment Company Directors
Broker/Dealer Advisory Committee
Investment Advisers Committee
Pension Committee
Pension Operations Advisory Committee
Retail SMA Advisory Committee
SEC Rules Committee SUBJECTS: Advertising
Compensation/Remuneration
Compliance
Disclosure
Distribution
Exchange-Traded Funds (ETFs)
Fees and Expenses
Intermediary Oversight
Operations
Pension
Recordkeeping
Technology & Business Continuity RE: ICI Files Comment Letter with SEC on Predictive Data Analytics Proposal

On October 10, ICI filed a comment letter with the Securities and Exchange Commission (SEC or "Commission") on its proposal regarding conflicts of interest associated with the use of predictive data analytics (PDA) and other "covered technologies" by broker-dealers and investment advisers ("Proposal").[\[1\]](#) ICI's letter is attached and is summarized below.

Proposed Rules 15l-2 under the Securities Exchange Act of 1934 ("Exchange Act") applicable to broker-dealers and 211(h)(2)-4 under the Investment Advisers Act of 1940 ("Advisers Act") applicable to registered investment advisers ("Proposed Rules") would require firms to evaluate their use of covered technologies in connection with investor interactions and to eliminate or "neutralize" certain conflicts of interest associated with such use. The Commission also proposes amendments to rules under the Exchange Act and

Advisers Act that would require firms to make and maintain certain records in accordance with the Proposed Rules.

ICI's letter urges the SEC to withdraw the Proposed Rules. They are unnecessary and would have detrimental consequences for the very investors the SEC seeks to protect. While focusing on the purportedly unique risks raised by investment advisers' and broker-dealers' use of certain technologies, the Proposed Rules would fundamentally change well-established legal principles that govern how firms and their representatives address conflicts of interest in compliance with the federal securities laws. The Proposed Rules raise constitutional issues by unduly restricting firms' ability to communicate with investors. The Commission neither has adequately demonstrated the existence of a problem that would justify such a radical change in regulation, nor has it provided sufficient public notice of its intent to do so. Furthermore, the Proposal exceeds the Commission's statutory authority and violates the Administrative Procedure Act (APA) and the Commission's rulemaking obligations under the securities laws. The Commission has failed to adequately analyze the tremendous costs of this vague, flawed, and wide-ranging proposal for market participants, including investors, which would outweigh any potential benefits. The letter further notes that members of Congress recently raised similar concerns regarding the Commission's basis and authority for issuing the Proposed Rules.

ICI's letter explains that the SEC should withdraw the Proposed Rules for the following reasons:

- The Commission has provided no basis or evidence that the Proposed Rules are needed. The Proposed Rules are confusing, unworkable, and overreaching and would harm the very investors the Commission seeks to protect by stifling innovation, restricting financial education, and effectively limiting investors' ability to access, through technology, affordable advice and investment products;
- Existing Standards of Conduct^[2] for advisers and broker-dealers fully and appropriately address any concerns the SEC may have regarding conflicts of interest raised by new technologies;
- The Proposed Rules violate the First Amendment by unduly limiting, without adequate justification, how firms can communicate with investors and potential investors;
- The Proposed Rules exceed the Commission's statutory authority;
- The Proposal violates the APA and the Commission's statutory duty to consider effects on efficiency, competition, and capital formation in rulemaking. While the Proposal focuses on potential concerns raised by new technologies, the Proposed Rules would broadly change existing regulation without adequate explanation or appropriate notice and comment, and therefore are arbitrary and capricious. The Commission's economic analysis is fundamentally flawed, as it does not identify or analyze the costs and benefits of such a radical change to existing legal standards. By not identifying and analyzing the extensive implications of the Proposed Rules for existing regulations applicable to firms and, more broadly, for how firms use technology in their day-to-day businesses and to interact with investors, and the impact of categorically eliminating or neutralizing essentially all conflicts of interest, the Commission fails to adequately identify or consider the Proposal's costs and burdens, which overwhelmingly outweigh any potential benefits; and
- ICI's own economic analysis finds that the Proposal fails to demonstrate any potential benefits to outweigh the Proposed Rules' tremendous costs. Based on the SEC's own cost estimates, the Proposed Rules, if adopted, would impose costs of over \$10 billion over the first 10 years alone. We believe, however, that this analysis significantly

understates costs due to errors of omission and implausible assumptions in the Commission's analysis. Our analysis instead finds that the potential costs are likely to be several times higher than the Proposal estimates. The actual costs of the Proposed Rules, if adopted, are expected to be at least \$30 billion in the first ten years.

Existing Standards of Conduct include well-developed principles for addressing conflicts of interest that can be readily tailored to new technologies and other market developments. The Commission should seek to promote a regulatory environment that encourages technological innovation that benefits investors and markets, rather than proposing rules that would have a severely chilling effect on technological innovation and are harmful to investors and markets. The Commission therefore should first obtain additional industry feedback through roundtables and other opportunities for public input, carefully identify any existing problems specific to the use of technology that may need to be addressed, and tailor a solution proportionate to any specific concerns it identifies. Further, the Commission should consider holistically the implications of the Proposal in combination with those of its other proposed and existing rules.

ICI's comment letter focuses on the Proposed Rules' implications for (i) registered investment advisers, in their capacity as advisers to registered investment companies and separately managed accounts; (ii) registered investment companies, including mutual funds, exchange-traded funds, and closed-end funds (together, "funds") and their investors; and (iii) registered broker-dealers that sell fund shares. Our perspective reflects the important role each of these entities plays in helping retail investors achieve their investment goals.

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Notes

[1] For a summary of the Proposal, please see ICI Memorandum No. 35390 (Aug. 2, 2023), available at <https://www.ici.org/memo35390>.

[2] Regulation Best Interest ("Reg BI") and the fiduciary duty applicable to investment advisers ("IA Fiduciary Standard," collectively, the "Standards of Conduct").